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Supreme Court of the United States

No. 759

DAVID STERN III et al.,
Petitioners

versus

UNITED STATES OF AMERICA,
Respondent

PETITION FOR CERTIORARI TO THE COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR CERTIORARI TO THE COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners seek certiorari to review a judgment of the Court of Appeals for the Fifth Circuit, and, in support of their petition, show:

OPINIONS BELOW AND JURISDICTION

The opinion of the District Court is reported at 164 FS 847. The *per curiam* of the Court of Appeals has not yet been reported. Both opinions are printed in the appendix hereto.

The Court of Appeals rendered its judgment on February 18, 1959.

Jurisdiction of this court lies under 28 USC 1254.

QUESTION PRESENTED

The novel question of federal statutory construction presented for review is:

> Does a non-copyrightable fictional character —in this case, a talking Army mule named *Francis*—first conceived and used by its creator in a literary setting, then sold by him independently of that setting, for exclusive use by the purchaser in motion-pictures with other story settings, and in other media, fall within the Internal Revenue Code's 1950 exclusion from "capital assets", of "a copyright; a literary, musical or artistic composition; or similar property"?

The ground on which the district court and the Court of Appeals held the character to be a "literary composition", is that the character was first used in a literary setting.*

The holding appears to conflict with the Ninth Circuit's holding, in *Warner Bros. Pictures vs Columbia Broadcasting System*, 216 F2d 945, cert. den., 348 US 971, that the principal character in a book is a separate entity, existing and vendible independently of the book.

This case is the first to determine the scope of the Revenue Code's exclusionary reference to "a copyright; a literary, musical or artistic composition; or similar prop-

* "The character Francis gets its definition and delineation from the book. The literary description in the book composes the character. How can it be said that the book is a literary composition yet the main character delineated therein is not? A slice of the loaf is still bread." 164 FS at 852; R 110-11. The Court of Appeals affirmed, *per curiam*, on the district court's opinion.

erty", which was added to the Code by amendment in 1950.

Since the subject of the case is concededly near the borderline of the 1950 amendment's ambit, the case presents an apt occasion for threshold consideration, and authoritative determination, of the amendment's scope.

STATUTE AND REGULATION INVOLVED

Internal Revenue Code (1939), section 117(a)(1)(C), 26 USC 117(a)(1)(C), 64 Stat. 932:

> "The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—
>
> * * *
>
> "(C) a copyright, a literary, musical or artistic composition; or similar property; held by
>
> "(i) a taxpayer whose personal efforts created such property".

Treasury Regulations 118, section 39.117(a)-1(c), 26 CFR, section 39.117(a)-1(c):

> "A copyright, a literary, musical or artistic composition, and similar property are excluded from the term 'capital assets' if held by a taxpayer whose personal efforts created such property . . . The phrase 'similar property' includes, for example, such property as a theatrical production, a radio program, a newspaper cartoon strip, or any other property eligible for copyright protection (whether under statute or common law),

but does not include a patent or an invention, or a design which may be protected only under the patent law and not under the copyright law."

STATEMENT OF THE CASE

Petitioners are husband and wife who filed joint federal income-tax returns in respect of the taxes at issue in this suit.

While petitioner David Stern was in the Army during the second World War, he conceived the character *Francis*, an Army mule who can talk.*

Since Mr. Stern is a newspaper business executive, who writes only as a hobby, and he was then in administrative charge of an Army newspaper, he first used the character in a series of sketches published in an Army magazine. R 54-55. After the war, some of the sketches appeared in book form. R 58-59.

In 1947, Mr. Stern sold the motion-picture rights to the book and Universal Pictures Company produced the picture "Francis", which was based on a script written by Mr. Stern, and was an outstanding success. R 60, 61-62, 63, 96, 123-25.

Thereafter, in 1950, Universal bought the character *Francis* from Mr. Stern. The character was not bought

* "To tell the truth about it sounds almost as though I am attempting to be humorous, which I am not, but after I had been in Hawaii a short time, I began pondering if there was anything lower than a second lieutenant, and purely for my own amusement one evening in the barracks I wrote four or six pages of dialogue between an imaginary talking mule and a second lieutenant." R 54.

for any literary value, but only for use by the purchaser exclusively, in other films with other story settings, and in other media.

All rights to the original book, as well as to a sequel "Francis Goes to Washington" (a commercial failure), were included in the sale; but only in order to assure to Universal, exclusive rights to the character for other purposes. Universal has never made any use of the book rights. R 86-87, 125, 127.

Universal has produced six successful motion pictures based on the character purchased by it: "Francis Goes to the Races", "Francis Goes to West Point", "Francis Goes to the Big - -n", "Francis Joins the WACs", "Francis Joins the Navy" and "Francis in the Haunted House". R 124-25.

None of these pictures was based on either of Mr. Stern's books, or on any script prepared by him; and Mr. Stern had no direct connection whatever with production of any of the pictures. R 87-88, 125.

The character has also been used commercially, by or under license from its purchaser, in dolls, rubber balloons, a song, a phonograph record and a comic strip. R 124.

Petitioners reported as capital gains, the amoun- re- ceived by them for sale of the character. The Go-rn- ment, contending that the character was not a capi- asset, assessed additional income taxes which petitioners paid, and for refund of which this suit is filed.

The district court recognized the transaction as the sale of a "capital asset" as to installments of the purchase price for the year 1950 (before the 1950 amendment was effective); but denied such recognition as to portions of the purchase price received in later years, on the ground that the character was a "literary composition" within the ambit of the 1950 amendment to the Internal Revenue Code.

This judgment was affirmed, *per curiam*, by the Court of Appeals, on the opinion of the district court.

ARGUMENT

This is the first decided case construing the 1950 amendment to the Internal Revenue Code which denies capital-gain treatment to the proceeds of the sale of "a copyright; a literary, musical or artistic composition; or similar property".

The type of property involved in this case is obviously near the line of demarcation between property covered, and property not covered, by the amendment.

In holding the character *Francis* to be a "literary composition", merely because it was first used in a literary context—in thus confusing with its first vehicle or medium, an intellectual conception clearly separable, and, in fact, entirely separate, from that medium—the decision of the courts below appears to be in direct conflict with the Ninth Circuit's holding, in *Warner Bros. Pictures vs Columbia Broadcasting System*, 216

F2d 945, cert. den., 348 US 971, that the principal character in a book is a separate entity from, existing and vendible independently of, the book.

The holding below also takes no account of the settled juridical definition of the term "literary composition"—in light of which definition Congress must be supposed to have used the term in this instance—as meaning the expression of thoughts in words, not such a mere inchoate conception as a fictional character which exists independently of the verbal descriptions in which it was first conceived.[1]

It should perhaps be noted that the conclusion of the courts below is not fortified by the district court's reference to "the catchall, 'similar property,' which appears at the end of the amendment".

It seems clear that the chord of similarity, which links the quoted phrase to the specific enumeration preceding it, is copyrightability;[2] and it is equally clear that a character is not susceptible of copyright.[3]

[1] See Wincor, *The Seven Basic Program Properties*, 47 Trademark Reporter 440 (1957); *Bowen vs Yankee Network*, 46 FS 62 (DC Mass.-1942); *Hewitt vs Coward*, 41 NYS2d 498 (1943), aff'd, 45 NYS2d 118; *Keene vs Wheatley*, 14 Fed. Cas. 180 (CC Pa.-1861); *Woolsey vs Judd*, 11 NY Super. (4 Duer) 379 (1855). A number of well-known characters unconnected with literary compositions come to mind: Charlie Chaplin's tramp, Uncle Sam, John Bull, the Republican Elephant, the Democratic Donkey (the character *Francis* served for a time as mascot to the Democratic Party), the Teddy Bear. Some characters, like Mickey Mouse, first found expression in non-literary media and later became the subject of literary works.

[2] The Government's own regulation construing the amendment distinguishes between copyrightable property, which is sub-

It is respectfully submitted that the decision below is in direct conflict with the cited opinion of the Court of Appeals for the Ninth Circuit, and diverges from that applicable precedent in the precedential initial construction of an important federal statute; and that the case accordingly warrants exercise of this court's jurisdiction by certiorari.

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March, 1959

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ject to the amendment, and other types of property, which are not. Treasury Regulations 118, section 39.117(a)-1(c), quoted on pages 3-4 above.

[3] See *Warner Bros. Pictures vs Columbia Broadcasting System*, 216 F2d 945 (CA 9-1954), cert. den., 348 US 971; *Detective Comics vs Bruns Publications*, 111 F2d 432 (CA 2-1940); *Nichols vs Universal Pictures Corporation*, 45 F2d 119 (CA 2-1930).

APPENDIX

Opinion of the District Court

WRIGHT, District Judge:

This case concerns "Francis," the talking mule. Francis is a product of World War II. It was created by a lonely second lieutenant in the Pacific theater of operations who sometimes wondered whether there was anything in the Army lower than a second lieutenant. Francis convinced him there was. Now, seven motion pictures later, that second lieutenant, the taxpayer here, is claiming that the income from "Francis" is entitled to capital gains treatment under the Internal Revenue laws.

In 1933, after attending Harvard University, David Stern III was employed as a dramatic critic for the *Philadelphia Record*, a newspaper owned by his father. Beginning four months later, he became successively comptroller of the *Record*, classified advertising salesman, assistant classified manager, classified manager, promotion manager, and general manager. During the time that Stern was learning the business, he continued to serve the *Record* as part-time dramatic critic. In 1938 he became publisher of the *Courier-Post* newspapers in Camden, New Jersey. Throughout the prewar years, when Stern was a newspaper business executive, his hobby was writing. He wrote some stories and articles in his spare time, but he was unable to sell any of them.

In the spring of 1943, Stern enlisted as a private in the United States Army. He was later commissioned as a

second lieutenant, and subsequently became co-officer in charge of the Central Pacific Edition of *Stars and Stripes*. While in the Pacific, Stern wrote some imaginary dialogue between a second lieutenant and an old Army mule, some of which he sold to *Esquire* for approximately $200. He also wrote several short stories while in the Army which he sold to magazines for $50 to $250.

After his release from the Army in 1946, Stern returned to Camden as publisher of the *Courier-Post* newspapers. In 1947 Stern's connection with the *Courier-Post* newspapers was terminated. He immediately entered negotiations to purchase a newspaper. While so doing and at the suggestion of a book publisher, he rewrote in book form all of the episodes about the talking mule, Francis. During this period he also wrote a sequel to "Francis," called "Francis Goes to Washington." It, too, was published by Farrar-Strauss, publisher of "Francis." In July 1949 Stern completed negotiations for the purchase of *The New Orleans Item* and took over the controlling interest and active management of the newspaper as its publisher. Since that date, he has devoted virtually his full time to the newspaper business as publisher.

On June 2, 1950 Stern sold to Universal Pictures Co., Inc., all of his "right, title and interest * * * in and to * * * that certain character known as 'FRANCIS' conceived and created by" him, together with all of his rights to the two novels mentioned above and all of his rights to any contracts with respect to the properties conveyed. In consideration of this transfer, Uni-

versal agreed to pay him $50,000 plus 5% of the net profits from photoplays based on the character Francis, and 75% of all sums received by Universal under contracts for the use or licensing of the property. Payment of the $50,000 entitled Universal to a "commitment period" of two years within which to make a motion picture. Thereafter, and following release of each picture, Universal was entitled to additional commitment periods by paying a similar fixed consideration of $50,000 as to each picture or period. The contract further provided that "if purchaser shall elect not to pay fixed consideration with respect to any next succeeding commitment period * * * the property shall revert to the seller." all rights in motion pictures produced to remain in Universal. Under this agreement, Universal produced six additional motion pictures[1] in which the character Francis was used. Stern prepared the screen play for the first of these pictures but has had no connection whatever with the writing or production of subsequent pictures except occasionally and incidentally as a consultant. The novel, "Francis Goes to Washington," was not used for screen material.

Plaintiffs have reported as ordinary income for tax purposes all amounts received by them from the sale of the motion picture and publishing rights to the novel "Francis," for preparing a short screen treatment of the book, "Rhubarb," and income received under the agreement for writing screen plays. Only those amounts

[1] In 1949 the first Francis movie was produced. It was based on the novel, "Francis," and the taxpayer here wrote the screen play. Its production, of course, was not pursuant to the June 2, 1950 contract in suit.

received from Universal for the character Francis have been treated by plaintiffs as capital gains, accrued during the years received. For the year 1950, the Internal Revenue Service originally accepted plaintiffs' treatment of this income as capital gains from the sale of the character Francis. In considering subsequent years, the Appellate Division of the Internal Revenue reopened the return for the year 1950 and ruled that income from the character Francis was not subject to capital gains treatment for the reason that the contract with Universal was not a sale of the character Francis, that if it were, Francis was property held by the taxpayer primarily for sale to customers in the ordinary course of his business and, further, under the provision of Section 210(a) of the Revenue Act of 1950, amending the provisions of Section 117(a)(1) of the Internal Revenue Code of 1939, the character Francis was similar to a copyright, a literary or artistic composition and, therefore, not a capital asset.

Taxpayer has paid the Government the asserted deficiencies in income taxes for the years 1950-53 resulting from the Commissioner's refusal to recognize his treatment of amounts received from Universal Pictures Company pursuant to the contract in suit as a long-term capital gain. Timely claims for refund have been filed and disallowed, after which disallowance this suit was instituted. Taxpayer's position here is the same as it has been since the filing of his original income tax returns. He states that his contract with Universal Pictures Company was a sale of the capital asset, Francis, not in the ordinary course of his business, and, consequently, he is entitled to capital gains treatment of the income re-

ceived from that sale. The Government here takes the same position taken by the Appellate Division of Internal Revenue Service as well as the Commissioner in his disallowance of the claim for refund.

The question as to whether the taxpayer's contract with Universal Pictures is a sale will be considered first because if it is not a sale, it will be unnecessary to consider the other objections to capital gains treatment of the income made by the Government. It will be noted in the contract that Stern sold all of his interest in the books "Francis," and "Francis Goes to Washington," the character Francis, and all rights and pending contracts concerning them. The agreement makes reference to "the full and complete ownership in the property sold, transferred and granted to (Universal) hereunder." It declares that Stern "hereby sells, transfers and conveys * * * all right, title and interest" in the property to Universal and guarantees "the full benefit of (Universal's) full and complete ownership in the property." Obviously, the draftsmen of this contract intended that it be a sale and called it such. Apparently they were familiar also with the one case, *Cory v. Commissioner of Internal Revenue*, 2 Cir., 230 F.2d 941, which the Government cites as authority for its contention that this agreement is not a sale, because the language of the agreement leaves no doubt that Stern transferred his entire bundle of rights in all the Francis properties, together with rights of future exploitation, to Universal Pictures. Thus this agreement is different from the agreement under consideration in *Cory v. Commissioner, supra*, because there the agreement provided for "a transfer of a part of the cluster of

rights" inhering in the taxpayer. *Cory v. Commissioner, supra*, at p. 944.[2]

The Government's suggestion, without citation of authority, that the contract in suit is not a sale because it provided for contingent payments of indeterminate sums similar to royalties, and because the property reverted back to Stern if the fixed consideration for any period is not paid, cannot convert this contract of sale into a licensing agreement. Perhaps a sale which provides for contingent payments of indeterminate sums and reversion does violence to the doctrinaire concepts of what a sale should be. But the tax cases[3] interpreting Section 117 of the Code have so long and so consistently held such contracts to be sales that the Internal Revenue Service itself in a recent ruling[4] is now indicating its acquiescence in this classification.

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[2] The full text, pertinent here, from *Cory v. Commissioner, supra* at p. 944, reads:

"We do not now decide that a transfer by a citizen of but a part of the bundle for a definite sum, or a transfer of the whole for an indeterminate sum, is a sale for purposes of Section 117. We do hold that when, as here, the transfer is both (1) a transfer of a part of the cluster of rights and (2) for an amount wholly indeterminable at the time of the transfer, no such sale occurs."

[3] *Waterman v. Mackenzie*, 138 U.S. 252; *Rude v. Westcott*, 130 U.S. 152; *Lawrence v. United States*, 5 Cir., 242 F.2d 542; *Massey v. United States*, 7 Cir., 226 F.2d 724; *Watson v. United States*, 10 Cir., 222 F.2d 689; *Allen v. Werner*, 5 Cir., 190 F.2d 840; *Hofferbert v. Briggs*, 85 F.Supp. 941, 944, aff'd 4 Cir., 178 F.2d 743; *Commissioner of Internal Revenue v. Celanese Corp.*, D.C. Cir., 140 F.2d 339; *Commissioner of Internal Revenue v. Hopkinson*, 2 Cir., 126 F.2d 406; *First National Bank of Princeton v. United States*, D.C., 136 F.Supp. 818; *Gershwin v. United States*, Ct. Claims, 153 F.Supp. 477, 480; *Herman Shumlin*, 16 T.C. 407; *Carl G. Dreymann*, 11 T.C. 153; *Edward C. Myers*, 6 T.C. 258.

[4] I.R.S., TIR-81, 6-27-58.

The Government next contends that if the contract in suit is a sale, then the income therefrom is still not entitled to capital gains treatment because it was a sale of "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Section 117 (a)(1)(A), Internal Revenue Code of 1939. The resolution of this question depends on appraisal of the total factual situation. *Smith v. Commissioner of Internal Revenue*, 5 Cir., 232 F.2d 142; *Consolidated Naval Stores Company v. Fahs*, 5 Cir., 227 F.2d 923. Unquestionably, under Section 117 (a) of the Code, a taxpayer may have more than one business. *Snell v. Commissioner of Internal Revenue*, 5 Cir., 97 F.2d. 891. Before any business can come within Section 117 (a), however, it must be an "occupational undertaking which required the habitual devotion of time, attention or effort with substantial regularity." *Thomas v. Commissioner of Internal Revenue*, 5 Cir., ...F.2d...., April 17, 1958. The criteria in making this determination are fully set forth in opinions by the Fifth Circuit[5] so it would serve no useful purpose to repeat them here. Those cases do show that a court should not be quick to put a man in business under Section 117 (a) simply because he has been successful in earning extra income through a hobby or some other endeavor which takes relatively small part of his time.

Here the taxpayer is a newspaper publisher and has been, with the exclusion of the war years, actively directing newspapers since 1938. Virtually his entire time

[5] *Gamble v. Commissioner of Internal Revenue*, 5 Cir., 242 F.2d 586; *Smith v. Dunn*, 5 Cir., 224 F.2d 353.

has been given to that endeavor. As a hobby he has written a few short stories, some of which have been productive of small amounts of income. On two occasions he has written screen plays. He has created the character Francis and written two novels about it. This literary work has taken relatively little of his time. It was more or less a relaxation from his principal employment. Under the circumstances, it can hardly be said that the taxpayer created "Francis" to hold as "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."[6] Section 117 (a)(1)(A), I.R.C., 1939.

The Government makes much of the fact that in one of the schedules attached to taxpayer's return, he professes to be a writer. Even if the taxpayer were responsible for this statement, his literary license in this regard should not be allowed to affect the tax treatment accorded his income.[7] Actually, the indication of Stern as a writer was the work of the accountant who prepared the return. It is further noted that the schedule on which the profession appears relates to income and expenses attendant his writing. On the first page of each return in the space provided for "Occupation," the word "Publisher" appears.

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[6] The Court has considered the cases cited by the Government on this point and finds them all factually distinguishable. See *Rider v. Commissioner of Internal Revenue*, 8 Cir., 200 F.2d 524; *Goldsmith v. Commissioner of Internal Revenue*, 2 Cir., 143 F.2d 466; *Fackler v. Commissioner of Internal Revenue*, 6 Cir., 133 F.2d 509; *Snell v. Commissioner*, *supra*.

[7] See *Thomas v. Commissioner of Internal Revenue*, *supra*, at p. ...., wherein it is stated that the designation of the occupation of the taxpayer on his income tax returns is "of little significance in fixing the character of the holding of the property * * * sold by him."

Finally, and unfortunately for the taxpayer, the Government's position on the 1950 amendment to the 1939 Code is well taken. That amendment excludes from capital gains treatment income from the sale of "a copyright, a literary, musical, or artistic composition; or similar property" held by "a taxpayer, whose personal efforts created such property." The purpose of this amendment is obvious. It is intended to deny capital gains treatment to income from the sale, by their creator, of literary, musical, or artistic compositions, or similar property. Prior to 1950, various rulings of the Internal Revenue Service had approved capital gains treatment of various literary, musical and artistic compositions, including books and radio programs. Congress determined to eliminate such treatment for such compositions.[8] Hence the amendment.

The taxpayer contends that the character "Francis" is not covered by the amendment, that it is not subject to copyright, that it is not a literary, musical or artistic composition or similar property. He argues that he has paid his taxes at the regular rates on all his income from his writings. He states that the character "Francis" is an "intellectual conception", and that as such the income from the sale thereof is entitled to capital gains treatment.

The taxpayer cites several cases[9] in support of his position that the character Francis is not subject to being

[8] See 1950 U. S. Code Congressional Service, pp. 3097, 3140 and 3230.

[9] *Bobbs-Merrill v. Straus*, 2 Cir., 147 Fed. 15, aff'd. 210 U.S. 339; *Warner Bros. Pictures v. Columbia Broadcasting System*, 9 Cir., 216 F.2d 945, 948, cert. den. 348 U.S. 971; *Universal Pictures Co. v. Harold Lloyd Corp.*, 9 Cir., 162 F.2d 354, 363;

copyrighted. And he spends much time in his brief arguing that the Internal Revenue Service itself has limited the words of the statute "or similar property" to property capable of being copyrighted.[10] It is not necessary for this Court to appraise the taxpayer's citations, his argument on this point, or the counter citations[11] and argument of the Government. It is this Court's view that the character Francis, irrespective of its susceptibility to copyright, is "a literary composition" and as such the income from the sale thereof is not entitled to capital gains treatment. The taxpayer concedes, as he must, that the novel, "Francis," in which the character Francis is the leading figure, is a literary composition, but he argues that Francis, the principal characterization in the book, is not. In this he is mistaken. The character Francis gets its definition and its delineation from the book. The literary description in the book composes the

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Nichols v. Universal Pictures Corp., 2 Cir., 45 F.2d 119, 121; *Dymow v. Bolton*, 2 Cir., 11 F.2d 690; *Chappell & Co., v. Fields*, 2 Cir., 210 Fed. 864; *Savage v. Hoffman*, D.C., 159 Fed. 584; *Bloom & Hamlin v. Nixon*, D.C. 125 Fed. 977.

[10] The taxpayer refers to that portion of the Treasury Regulations (Treas. Reg. 118, Sec. 39.117 (a)-1) which reads as follows:

"The phrase 'similar property' includes, for example, such property as a theatrical production, a radio program, a newspaper cartoon strip, or any other property eligible for copyright protection (whether under statute or common law)."

But see Section 3797 (b) of the Internal Revenue Code which reads:

"The term 'includes' and 'including' when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined."

[11] *Lone Ranger, Inc. v. Cox*, 4 Cir., 124 F.2d 650; *Fleischer Studios v. Ralph A. Freundlich, Inc.*, 2 Cir., 73 F.2d 276; *King Features Syndicate v. Fleischer*, 2 Cir., 299 Fed. 533; *Wilson v. Haber Bros.*, 2 Cir., 275 Fed. 346; *Hill v. Whalen & Martell, Inc.*, D.C., 220 Fed. 359.

character. How can it be said that the book is a literary composition yet the main character delineated therein is not? A slice of the loaf is still bread. It would be absurd to attribute to Congress the intention, under the 1950 amendment, of covering whole literary compositions but not parts thereof, particularly in view of the catchall, "or similar property," which appears at the end of the amendment.

Without the literary description of Francis, his mannerisms and his manifestations, Francis would cease to exist. In any event, an amorphous Francis could hardly be called "property held by the taxpayer," the sale of which is entitled to capital gains treatment. Section 117(a)(1), I.R.C., 1939. If Francis is, as taxpayer suggests, an "intellectual conception," sans form and substance, existing in the mind alone, it is incapable of ownership and, therefore, of being "property held by the taxpayer." See *Holmes v. Hurst*, 174 U.S. 82, 86; *Nichols v. Universal Pictures Corporation*, 2 Cir., 45 F.2d 119, 121. If Francis has sufficient form and substance to be considered property capable of ownership, this is so because of its literary composition. Compare *Warner Bros. Pictures v. Columbia Broadcasting System*, 9 Cir., 216 F.2d 945.

The taxpayer is entitled to capital gains treatment on the income from the contract in suit for the year 1950 because the 1950 amendment to the Code does not apply to income received during that year.[12] As to subsequent

[12] In the Report of the Senate Finance Committee accompanying that legislation it is stated (S.Rep. no. 2375, 81st Cong., 2d Sess., p. 85 (1950-2 Cum. Bull., 483, 544)):

"In the case of the sale prior to the effective date of the amendment, of an artistic work by a creator who has

years, however, capital gains treatment of the income from the contract must be denied as proscribed by that amendment.

Judgment accordingly.

Judgment of the District Court

This cause was submitted, by stipulation of the parties, for decision on the record and briefs.

The court, after considering the evidence, and the briefs filed by the parties, having, on August 11, 1958, rendered its written opinion; now therefore,

It is Ordered, Adjudged and Decreed that plaintiffs, David Stern III and Louise Beggs Stern, recover from defendant, United States of America, the sum of four thousand eight hundred fifty-four and 08/100 ($4,854.08) dollars, with interest at six (6%) per cent. per annum from May 31, 1956 until paid.

It is Further Ordered, Adjudged and Decreed that the within action be, and it is, hereby dismissed as to plaintiffs' claims for refund of income taxes for the years 1951, 1952, and 1953.

Opinion of the Court of Appeals

Per Curiam: Upon consideration, we agree with the views ably expressed by the district court in its opinion

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elected the installment basis under Section 44, the tax treatment of installment payments received after such effective date will be governed by the rule of *Snell v. Commissioner* (97 F.2d 891)."

reported in 164 F. Supp. 847. For the reasons and upon the authorities there stated, the judgment is affirmed.

Judgment of the Court of Appeals

This cause came on to be heard on the transcript of the record from the United States District Court for the Eastern District of Louisiana, and was argued by counsel;

On Consideration Whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, Affirmed.

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No. 769

In the Supreme Court of the United States

OCTOBER TERM, 1958

DAVID SIEBEN III ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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Sec. 117(a) (26 U.S.C. 117(a))	2, 6, 7
Revenue Act of 1950, c. 994, 64 Stat. 906, Sec. 210(c)	6
Miscellaneous:	
H. Rep. No. 2319, 81st Cong., 2d Sess., pp. 54, 91–92 (1950–2 Cum. Bull. 380, 420–421, 445–446)	7
S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 83–84 (1950–2 Cum. Bull. 483, 543)	7
Treasury Regulations 118, Sec. 39.117(a)–1	3

501483—59

In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 759

DAVID STERN III ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (Pet. 9–20) is reported at 164 F. Supp. 847. The opinion of the Court of Appeals (Pet. 20–21) is not yet officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on February 18, 1959, and the petition for a writ of certiorari was filed on March 9, 1959. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1).

QUESTION PRESENTED

Whether the consideration taxpayer received during the years 1951–1953 for the sale of his entire

interest in certain literary property created by him was taxable as ordinary income rather than as capital gain by virtue of Section 117(a)(1)(C) of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a). *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; * * * or gains or profits and income derived from any source whatever. * * *

* * * * * *

(26 U.S.C. 22)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [As amended by Sec. 210, Revenue Act of 1950, c. 994, 64 Stat. 906] *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

* * * * *

(C) a copyright; a literary, musical, or artistic composition; or similar property; held by—

(i) a taxpayer whose personal efforts created such property, or

* * * * *

(26 U.S.C. 117)

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

> SEC. 39.117(a)–1 *Meaning of terms.* (a) The term "capital assets" includes all classes of property not specifically excluded by section 117(a)(1). In determining whether property is a "capital asset", the period for which held is immaterial.
>
> * * * * * *
>
> (c) A copyright, a literary, musical, or artistic composition, and similar property are excluded from the term "capital assets" if held by a taxpayer whose personal efforts created such property, or if held by a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property. As to the application of section 117(j) to the sale or exchange of such property held by such a taxpayer, see Sec. 39.117(j)–1. The phrase "similar property" includes, for example, such property as a theatrical production, a radio program, a newspaper cartoon strip, or any other property eligible for copyright protection (whether under statute or common law), but does not include a patent or an invention, or a design which may be protected only under the patent law and not under the copyright law.
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> * * * * * *

STATEMENT

During World War II, while the taxpayer was stationed in Hawaii as an Army officer, he wrote

several pages of imaginary dialogue between a lonely second lieutenant and an Army mule named Francis. The dialogue, which was a satire on Army life, was printed in an Army newspaper, and Francis the talking mule quickly became a popular figure. Taxpayer wrote additional dialogue for the Army paper, and he also wrote several short stories concerning Francis which he later sold to various magazines. (Pet. 9–10; R. 122.)[1]

After he was discharged from the Army, taxpayer wrote and obtained a statutory copyright on two novels entitled "Francis" and "Francis Goes to Washington". Both novels were sold to and published by Farrar-Strauss. In 1947, taxpayer sold the motion picture rights to the first novel to an independent producer, and in turn, the producer assigned his rights to Universal Pictures Company. Using a screen play written by taxpayer, Universal produced the motion picture "Francis" in 1949. (Pet. 10; R. 123–124.)

On June 2, 1950, taxpayer entered into a contract with Universal Pictures Company whereby taxpayer sold to Universal (Pet. 10; R. 126–128):

> 1. All his rights in the character known as Francis which he had conceived and created;
>
> 2. All his rights in the novels "Francis" and "Francis Goes to Washington" which he had written and copyrighted, including the titles, themes and contents of the novels, as well as the copyrights and renewal rights; and
>
> 3. All his rights accruing under prior con-

[1] Record references are to the record in the Court of Appeals.

tracts with other parties involving the above subject matter.

As consideration for the transfer, Universal agreed to pay taxpayer a fixed fee of $50,000, a share of all profits accruing under the prior contracts dealing with Francis, and $50,000 plus a share of the profits on each motion picture which Universal thereafter produced using the character Francis. (Pet. 10–11; R. 135–144.) Universal subsequently produced six such pictures. (Pet. 11; R. 124.)

On their joint returns for the years 1950–1953, taxpayer and his wife treated the amounts received from Universal pursuant to the above provisions of the contract as capital gains in the year of receipt. (Pet. 11–12; R. 125.)[2] The Commissioner determined that the amounts taxpayer received from Universal were ordinary income, and after paying the deficiencies determined by the Commissioner, taxpayer and his wife brought suit for a refund. The District Court allowed the refund claimed for the year 1950, but held that the proceeds received by taxpayer during the years 1951–1953 were taxable as ordinary income by virtue of Section 117(a)(1)(C) of the Internal Revenue Code of 1939, which was added to the Code by the Revenue Act of 1950. (Pet. 9–20.) Taxpayer and his wife appealed with respect to the years 1951–1953, and the Court of Appeals affirmed in a *per curiam* opinion. (Pet. 20–21.)

[2] Under the contract with Universal, taxpayer was also entitled to write screen plays for each Francis motion picture at a compensation of $10,000 per screen play. (R. 144–145.) The amounts taxpayer received for this work were reported as ordinary income. (R. 125.)

ARGUMENT

This is a case of first impression, the decision below is correct, and further review is not warranted.

1. Section 117(a)(1)(C) of the Internal Revenue Code of 1939, *supra*, p. 2, was added to the Code in 1950 to deny capital gain treatment to income derived from the sale of "a copyright; a literary, musical, or artistic composition; or similar property" held by "a taxpayer whose personal efforts created such property". The taxpayer in the case at bar created a fictional character in the process of writing numerous short stories and two copyrighted novels. Having created a character with popular appeal, taxpayer was able to sell his interest in the character and the novels to a motion picture company. (Pet. 10–11; R. 127–128.) The courts below were clearly correct in holding that the sales proceeds which taxpayer received in the years 1951–1953 were taxable as ordinary income, rather than as capital gain, by virtue of Section 117(a)(1)(C).[2]

Taxpayer's contention (Pet. 7) that the sale of a fictional character is not covered by the statute runs counter to the plain language and history of Section 117(a)(1)(C) and finds no support in any decision. Under taxpayer's view, income from the sale of a book is taxable at ordinary income rates, but income from the sale of a character in the same book is taxable at the preferential capital gain rates. Congress

[2] These provisions apply to the amounts received in the years 1951–1953, even though the sale in question took place prior to the enactment of Section 117(a)(1)(C). See Pet. 19, fn. 12, and Section 210(e) of the Revenue Act of 1950.

clearly did not intend or expect such an incongruous result when it provided in Section 117(a)(1)(C) that the ordinary income rates would apply in all cases where the creator of "a literary, musical, or artistic composition; or similar property" sold his creative work. In view of the obvious purpose of the statute, the language used by Congress is certainly broad enough to cover the case where the author of a literary composition sells it together with his interest in the principal character. Cf. *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 52. See also H. Rep. No. 2319, 81st Cong., 2d Sess., pp. 54, 91–92 (1950–2 Cum. Bull. 380, 420–421, 445–446); S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 83–84 (1950–2 Cum. Bull. 483, 543).

As the District Court indicated (Pet. 17–18), taxpayer's assertion (Pet. 7–8) that a fictional character can not be copyrighted is beside the issue, because there is nothing in the statute or the Regulations, *supra*, p. 3, to indicate that Section 117(a)(1)(C) applies exclusively to property which is eligible for copyright protection. Whether or not the central character of a book can be copyrighted as such, the sale of the author's interest in that character stands on the same footing tax-wise as a sale of the book itself, and the courts below were clearly correct in so holding. (Pet. 18–21.)

2. As taxpayer points out (Pet. 6), this is the first decided case involving the provisions of Section 117(a)(1)(C), and quite obviously, there is no conflict. Taxpayer's reliance (Pet. 2, 6–7, 8) on *Warner Bros. Pictures* v. *Columbia Broadcasting System*, 216 F.

2d 945 (C.A. 9), certiorari denied, 348 U.S. 971, a copyright infringement suit, is completely misplaced. No question of tax law was there involved, and in holding that a book and the central character in the book could be sold separately by the author, the court said nothing to suggest that the sales would be subject to different tax treatment.[4]

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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APRIL, 1959

[4] Moreover, the decision turned upon construction of a contract the terms of which differed materially from the contract here involved, the court holding that the author had not conveyed his interest in the characters used in his writings. Here, the taxpayer admittedly sold his right to both the novels and the characters. (Pet. 10–11, 18.)

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